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New inequality
Anatolii Gudym, 20 October 2004

Democracy and governing in Moldova
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The World Bank and International Monetary Fund eventually seem to agree on the date (November) of discussion of "Moldovan triennial" or Economic Growth and Poverty Reduction Strategy (2004-2006), which also took the government three years for its preparation. Most probably the Fund and Bank will approve this strategy and then our Parliament will put it into a legal document, the more so as the first year of this triennial comes to an end.

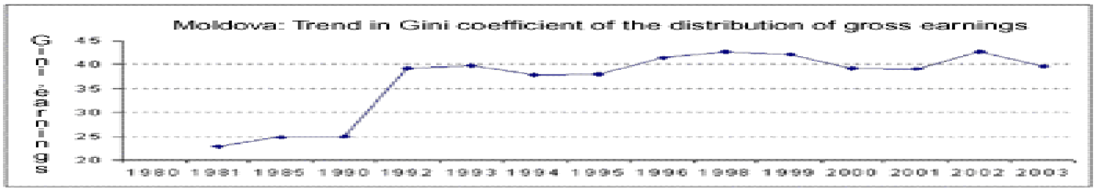
Do we switch to reforms of a new type?

Meanwhile, it was in parliament where a new initiative was stated: i.e. a transition to new type reforms. First this was said by the President V.Voronin at the close of summer session (on 28.07.2004) and then supported by speaker E.Ostapciuc at the opening of an autumn parliament session on 23.09.2004: "We are to initiate reforms of new types that would facilitate a more sustainable development".

The essence and methods of realization of the reforms of a new type yet to be interpreted. Still, it is encouraging that the President has acknowledged that the reforms should continue since the very fact of "both social stabilization and economic growth does not mean anything in a poor country". And this is true. GDP growth has resumed in Moldova since 2000 (its increase came to about 34% in 2000-2004) and this happened while the employment reduced (!) by 10%. Only about 40% of the growth was brought out by industry and agriculture; its growth was mainly caused by service sector, a rise in consumption and taxes levied on goods and import. Besides it was influenced by remittances transferred by our fellow citizens working abroad. It is clear that this pattern of growth guarantees the country neither sustainable development nor high rate of growth of GDP nor social rehabilitation of the population.

From equality to inequality

The assertion of Moldova being the poorest country of Europe became a stereotype. Here it should be added that such drastic social inequality between the new rich and the new poor has not evolved in any of the other 14 post socialistic countries of the Central-East Europe as it has happened in Moldova. After 1990 income inequality in terms of Gini coefficient applied by UNO has doubled and reached 40-44.



Thus, in the mid of 2004 only 6.2% of total household income volume fell to the share of 20% less secured families and 44.2% - to the share of 20% the most well-to-do families. Recent years revival of the dynamics has reduced a poverty zone in Moldova but it has not removed contrasts of inequality.

Nevertheless the majority of citizens of the RM still remember realia of a "developed socialism", when the state secured relative equality of incomes that basically depended on a salary (except nomenclature' privileges and "blat" - profitable connections).

Inequality began to increase rapidly during the transition period. At first it was caused by the fact that many people lost jobs and their money saving, and then - by process of privatization of enterprises, land and dwelling. Salaries paid in certain sectors became sharply different. Moreover, entrepreneurs have derived an income from shadow economy and employees of public offices - from corruption.

In Moldova in 1997-2003 real salaries grew annually by 7.7% starting from the mid 90s and after 1999 they have risen on average by 14.7% per year. On the other hand, at the same time the contrasts became even sharper. If in 1996 salaries in agriculture made up 2/3 of average salaries of national economy, then in 2003 they already came to ½. The same tendency took place in education and public health sectors. In 2003 salaries that exceeded an average level were paid in construction, transportation, industrial and financial sectors and public administration.

It is strange, but remittances sent from abroad also spurred the inequality. As the most initiative and educated part of the population went abroad for earning, 70 % of remittances get to well-to-do households. These remittances are spent mainly for consumption and also for "family investments" - for children education, purchase of apartments, land and investment into small business. Additionally, state social programmes do not facilitate much to elimination of inequality. Rendering of assistance in the programmes is based on a principle when citizens are assigned categories but it is not based on their real needs.

As a result, according to the Ministry of economy estimates (2003) only 6.6% of social transfers (without pensions) fell to the share of 20% less secured families and 46.0% to the most well-to-do families - recipients of such assistance.

Images of inequality

Inequality is many-sided. The tenseness of the situation also consists in that the inequality becomes apparent not only through contrasts in incomes or availability of property (which is an obvious sign for today), but through unequal conditions of access to the future - access to education and health care.

According to the sociologists data (2003) the number of days spent by the poor and the well-to-do in hospital are in the ratio of 1:11. The number of matriculated persons from the poor is tree times less than the number of matriculated persons from the well-to-do. Only every tenth is matriculated from the village youth that apply for admission to institutions of higher learning, while from the town-dwellers - every second.

It should be mentioned that the inequality in job opportunities available in Chisinau municipality (small business, construction, service and security sectors) and persistent stagnation for the rest of the territory, except 3-5 other towns (Edinet, Balti, Ungheni and Cahul).

Thus, many of the rights of citizens declared by our new democratic Constitution (1994) are difficult to realize. Thereby life of many people, especially young generation, is dominated by sense of vulnerability, impossibility to plan their future.

What is to be done?

One should not assert that the government does not see the inequality as a dangerous reason of social and political tension. Thus, in EG-PRSP for 2004-2006 "elimination of inequality and increase in participation of the poor in economic development" are mentioned as the priority. Basic approaches for this are well-known and approved in countries that undergo active reforms in transition:

- To increase employment for those who want and are able to work, to stimulate opening of new jobs - especially in a sector of small and medium business;
- To focus attention of the central government and administration of regions on the poorest localities;
- To make social assistance targeted for those who really need the state support.

At present the draft budget for 2005 is considered in Parliament. Again, the Government mentions that the state budget is "real and socially oriented". But to whom is it directed toward? Confucius said: "in a well-governed state they are ashamed of poverty, in a poorly ruled state they are afraid of wealth". Inequality is a real danger for a young, weak state. Or we are neither ashamed nor afraid?

What's in their for us in the draft budget for 2005?
Iurie Gotisan, 3 November 2004

Democracy and governing in Moldova
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The recently approved draft budget, which was said to be socially-oriented and pursuing objectives outlined in the Government Action Plan, is yet another evidence to Governments' incapacity to translate Communist Party's ideological message and political preferences into a budgetary vision. As it is primarily a political document and given approaching elections, the spending for the budgetary sphere has rose insignificantly by 340 million Lei, in particular for education, healthcare, and social security.

Moreover, considerable funds are to be allotted next year to special state services, public order, national defence - 23% of the total budget spending. Excessive funding of the force structures speaks for itself - incumbent power seeks to improve social-economic conditions in a rather specific manner, rather than by passing and enforcing laws that would spot and prevent various forms of corruption and embezzlement.

On the last 100 metres, budget for this year might be further undercut by some unforeseen spending that the Government had to assume. On top of that, during last week Government session Minister of Finance announced that due to the failure to collect all forecasted taxes, there was a budget "whole" worth 1 billion Lei in the state budget for this year. Having said this, it is very likely the macroeconomic targets set for the next year would not be met.

The fact that Moldova doesn't have a functional market economy would make all the problems even worse in an electoral year and would likely undermine all the social-oriented "moves" envisaged in the draft budget for 2005. The mere mention of "elections" brings the draft budget in the centre of electorate and contestants' attention with both of them seeking to exploit it to their own advantage, i.e. the former to ask the latter to provide or promise.

If we are to look back at the developments since September, the first to claim their rights were teachers who threatened to go on strike. And the timing was perfect, beginning of the school year. Government yielded and raised wages by 20%. On top of that on the last 100 metres before draft budget approval, Government took over even more of a burden: indemnifying pensions; raising allocations, compensations and indemnities; all in all an estimated at 890 million Lei. What the Government didn't do was to take into account fluctuating prices on raw materials and oil on the international market.

All of the aforesaid would wield a heavy pressure on achieving the targets set for the next year, namely: a 6% economic growth and keeping inflation below 9%. It's difficult to asses the impact of the swelling budget spending, as nobody works seriously with economic modelling in Moldova and there is not enough statistics data.

Early this year, a part of the healthcare employees agreed to adjourn negotiations on wages for the next year, however they have changed their mind lately seizing the right moment. As one government official put it, one cannot go to the polling stations when people are rallying nearby. Therefore, Government would have again to dig deep into its pockets and come up with new amendments to the draft budget so as to ease the spirits.

Yet once again, ruling party's generous promises are confronted with economic realities. Previously, ruling party's generosity was tempered by financial isolation brought by worsening relations with international monetary organisations. Recent decisions of the International Monetary Fund, currently with a mission in Moldova, to adjourn discussions on our country spoiled any hopes for an aid from abroad, or at least for an aid in the first half of 2005. Moldova would find it difficult to service foreign debt as well as to finance foreign deficit, i.e. trade balance and current account deficit.

Draft budget for 2005 promises lowering fiscal burden for legal and natural entities alike. In particular it promises to cut by 2% the income tax for legal entities, from 20% in 2004 to 18% in 2005; and income tax quotas for natural entities from 10%, 15% and 22% in 2004 to 9%, 14% and 20% in 2005. Ministry of Finance estimated that the move would roughly cost 1 billion Lei. Potentially, the move would pay back by surging investments from Moldovan business.

Apparently, the state lets the fiscal burden loose. In reality, envisaged moves would not reform taxation system, while their impact remains unclear. Moldovan officials keep promising jobs and wage-raise. However, draft budget paints a less robust picture, social contribution would drop from 28% to 27%, healthcare insurance would go up by 2%, and most importantly the idea of a single taxation quota was abandoned. Reinvesting profits, amidst lowering income tax from 20% to 18%, would rather be a constraint. An income tax as low as 18% might lure foreign investors. If this was the intention of the Government, then it fades when compared to 15% income tax in the region. On the contrary, ambiguous laws, bureaucracy, not to speak of the rule of law would scare any investor away.

Although it is said to be socially-oriented, the current draft budget follows fiscal and budgetary policies of the previous years. One of the rules of economic policies says that budget is a financial reflection of the state policies, but it seems this rule doesn't work in Moldova. Macroeconomic indicators used in drafting the budget for the next year, which Prime-Minister likes bragging about, have induced ecstasy among legislators. Unfortunately, Moldovan economy is not as healthy as Tarlev's Government wants to see it. Allegorically speaking, there is only one step to go from ecstasy to agony.

Financial rating and foreign competitiveness of Moldova
Iurie Gotisan, 18 November 2004

Democracy and governing in Moldova
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Following the visit Fitch experts to the Republic of Moldova, the agency reexamined long-term rating for the Republic of Moldova. The country rating would remain unchanged, i.e. B-, and this because Moldovan Government has a limited capacity to contract foreign loans and therefore has to tight its public spending.

Moreover, Fitch experts say the pace of reforms in Moldova is too slow, privatization is carried inadequately, public debt is swelling, whereas relations with IMF have been frozen. 'B' ratings indicate that significant credit risk is present, but a limited margin of safety remains. Financial commitments are currently being met; however, capacity for continued payment is contingent upon a sustained, favorable business and economic environment. Republic of Moldova bears many risks as regards investments. Therefore, general tendency of Moldova's credibility index seems quite bleak.

Entities or issues carrying the same rating are of similar but not necessarily identical credit quality, still interestingly enough Moldova lags behind all CIS countries, apart from Turkmenistan having a CCC- rating. Also, experts were concerned about high trade balance deficit reaching 515 million USD in the first nine months of the year. Even considerable remittances of Moldovans working abroad, as well as transfer to current account, were not able to slow down the swelling deficit.

According to the Ministry of Finance, in January - October 2004 Republic of Moldova reimbursed foreign debt worth 93 million USD. At the same time, to address the debt issue, Parliament amended the Law on State Budget, thereby enabling National Bank to grant a 50 million USD loan to the Government for it to redeem foreign debt. After all, it is not the mission of the National Bank to credit and fill budget wholes from its foreign currency reserves.

The move would propel inflation up and depreciate national currency. This has happened in Latin America in the 80's when the country's insolvency coupled with interference of politics in financial system resulted in the highest inflation ever. Going back to Moldova, amidst worsening relations with foreign creditors and IMF reluctance to credit policies spurring inflation, such moves not only will be useless in putting the fire down, but on the contrary would fuel it, as there are no guarantees that Government would reimburse the credit.

Given the lack on internal a sources, an alternative solution might be the urgent restructuring of foreign debt by means of Paris Club. However, good relations with IMF is a binding condition for the debtor to meet in order to initiate restructuring negotiations, which is not exactly the case of Moldova. Therefore, in order to restructure debts, Moldova would have to keep the path of reforms and most importantly observe the Memorandum signed with the Fund, especially as Moldova already managed to breach some of the provisions. On the other hand, similarly to international monetary organisations putting forward conditions Moldova should comply with, the state itself should act likewise with its debtors. Generally speaking, Government should be more persistent when dealing with administration of state enterprises, especially when privatization is not a solution.

From the time IMF mission left Moldova on November 3, it was clear that the country would not get foreign funding at least until mid-2005, which bears some risks for the economy. At the same time, according to officials from Ministry of Finance revenues provided for in the state budget would be revised, that is reduced. This would in turn bring some changes in the expenditures. At this time Government has a narrow berth for manoeuvres, especially as Minister of Finance stated earlier that because of lower revenues than forecasted there was a 1 billion Lei budget "whole".

Moreover, the forecasts I made in the previous issue of e-journal that macroeconomic targets would not be achieved, shortly proved to be right as the Parliament amended the Law on State Budget as regards economic forecasts for this year (*Romanian only*). Unless Government finds new sources of funding or gives up on some of its social and economic programs, it would have to resort again to the help of National Bank of Moldova, which as already mentioned might have disastrous consequences.

Besides funding domestic policies it is also necessary to reimburse foreign debt. It would be nearly impossible to restructure those debts without an agreement with IMF. Given the lack of foreign preferential credits, there is no way Government would manage to meet its financial commitments other than to dig into National Bank's foreign currency reserves. However, exhausting those resources would propel the prices further upwards and give rise to speculations on the national currency market. Among the immediate effects of such a more one may expect swelling prices, depreciation of the national currency, and most importantly more expensive imports of strategic goods on the eve of winter.

Remittances coming from Moldovan citizens working abroad would lower those risks, however Moldovans might well decide to keep the currency in their pockets if they smell price hike. This in turn would wield extra pressure on the exchange rate. Internal debt is already too high. Even if Government manages to balance its external financial position, it will do so on the expense of the internal one. Depending on the gravity of economic crisis, it may morph into a social and political crisis.

Currency Market: New Challenges
Veaceslav Negruta, 1 December 2004

Democracy and governing in Moldova
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The evolutions on the internal currency market at the end of November gave a lot of headaches to the local economic agents, especially to those whose activity depends directly or indirectly on Moldovan Leu's correlation with other foreign currencies. The US Dollar's spectacular fluctuations against other foreign currencies put financial markets and analysts on fire, also testing the nerves of some actors on the local market.
The Dollar's latest significant "fall" took place on Wednesday and Thursday, on 24 and 25 November, as a result of the declarations of some officials of the Central Bank of Russia about their intentions to increase the share of the Euro in the structure of its currency reserves from 30 to 40 percent in the Dollar's disfavour. The international financial market reacted promptly. China had previously announced its preferences for the Euro, which also troubled the waters on the financial markets.

However, the main reason for the Dollar's "fall" should be looked for in the USA. Probably many actors that play on the currency market have realized that the USA is interested in the Dollar's weakness in order to finance partially its war costs, finance the huge budget deficit and create competitive advantages on the internal and external markets for the American producers. The contradictory statements of the Minister of Finance and the Head of the US Federal Reserves with regard to the Dollar's future amplify these uncertainties. Moreover, the fears related to the high levels of both trade and current account deficits of the United States have generated a decreasing trend of the American currency. Monetary markets fear now that the decline that has been taking place so far gradually and orderly could become chaotic, with unpredictable consequences.

The hardest blow to the US dollar could be caused by the entering into force of the agreement of December 2003 between the German Chancellor Gerhard Schroeder and the Russian President Vladimir Putin regarding the payment in Euro for the import of Russian natural gases. Respectively, there could take place an unprecedented replacement of the US Dollar with Euro in the energy resources import/export transactions, this segment of the international market being traditionally dominated by the Dollar. The decision of the Central Bank of Russia to increase the share of the European currency in the total amount of its currency reserves is an alarming signal for its energy sector.

In case of US Dollar's depreciation, a new wave of price hike on energy resources is not excluded, or a more accelerated substitution of the Euro for the Dollar could become reality. Let us take a look at the Moldovan currency market. Although the Dollar loses its position and value on all international and national markets, the Leu/Dollar correlation remains relatively stable, even with a small depreciation of the Leu. This could be explained by the seasonal factor i.e. that the demand for dollars increased on the eve of winter (we must pay for the import of energy resources). But this explanation is not sufficient. It seems that the target for Leu's appreciation against the Dollar was set by President Vladimir Voronin at the Government meeting of 3

November 2004, when he brought harsh criticism to the National Bank and personally to its Governor Leonid Talmaci.

The Head of the State harshly criticized the activity of those NBM officers that allowed for Leu's appreciation, although the appreciation took place 5-6 months before. Back then, when the exporters and the population dependant on the external money transfers were suffering losses due to the Leu' appreciation, few were those that criticized the situation on the currency market (nobody at all from among the governors). For these reasons, the President's criticism was a little belated. Nevertheless, the criticism had its effects: today the Moldovan currency market does not react in the same way as practically all international and national markets do to the Dollar's evolution.

In the conditions in which the dollars are "thrown out" from international assets in the entire world, the Republic of Moldova becomes the place that absorbs the Dollar. The dollar throwing out phenomenon is obvious especially in Russia. Thus, those dollars could reach Moldova through economic agents, including commercial banks, which could bring about a new wave of pressure on the Leu/Dollar correlation.

It is important to understand the macroeconomic impact of the evolutions on the international currency market on Moldova's balance of payments. In the conditions in which most export contracts have prices fixed in Dollars, and import prices (except energy resources) in Euros (or related to the Euro), we have an increasingly disastrous situation with regard to the trade balance. Its deficit is continuously growing, especially due to the depreciation of the Dollar against the Euro. And the consequences of Leu's appreciation allowed for an increase in the trade deficit, which registered a record amount of USD 515 million in the nine months of this year, as well as an increase in the current account deficit.

At the same time, controlled currency regime (promoted, in fact, by NBM) has protected the internal currency market against the speculative flows and the multitude of negative evolutions on the international financial markets. NBM should change the frequency of its interventions on the currency market and offer an increased flexibility to the exchange rate. It is true that there is the option of using temporary controls, such as minimal obligatory reserves or restrictions in the loan provision policy. Perhaps the market players know them and are aware of what measures the central bank could adopt, should things go wrong at some point.

The Republic of Moldova is approaching more and more to the critical point when it must take a decision regarding the acknowledgement and acceptance of the increasing role of Euro in the world as well as in the Republic of Moldova. The delay in doing this has already degenerated in "missed opportunities". The current political and economic contexts will most likely not interfere with making such a decision.

Inflation rate gives headache
Iurie Gotisan, 16 December 2004

Democracy and governing in Moldova
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For the third time in 2004 monthly inflation rate exceeded 1% (1.1% - in April, 2.2% - October, 1.8% - November). One might seem surprised. One might as well express lingering concerns that the targeted inflation rate for the year would not be achieved, amidst a cumulative price hike of 10.7% in the first 10 months of the year.

Better still one might acknowledge that swelling inflation comes as no surprise. To put it differently, National Bank informed IMF and WB that Republic of Moldova might miss the 9% inflation target. Afterwards "official sources" talked to media of a different target, i.e. 10%. Noteworthy, if Central Bank had not taken the decision to let Leu appreciate, probably the cumulative inflation rate for 2004 would have been twice as big.

As a rule upon price hike, interest rates go up and not down. It is all-too-clear: Leu depreciation, meaning cheaper imports, seeks to reduce inflation, whereas interest rates seek to diminish the risk of speculative capital inflow.

Still, latest developments on the monetary market in 2004 marked by price hike (implicitly of the inflation) amidst considerable Leu appreciation, signals some risks as regards National Bank activity. We believe that appreciation of the exchange rate in real terms was brought about by National Bank promoted monetary policy of rigorous control of monetary base (M0). One may say that during the aforesaid period National Bank had a more of a directive policy.

At the same time, average interest rate on deposits surged (from 16.8% to 17%), especially due to growing deposits in Lei by natural entities. However, it is impossible to boost savings unless there are positive interest rates in real terms, while confidence in the national currency would drop if nominal interests on deposits did not exceed inflation rate.

Financial analysts say depreciation of US dollar would boost economic growth, however inflationist risk would eventually lead to restrictive economic policies mainly by raising interest rates, which would result in an inflow of foreign capital and investments, that in turn would boost production and create new jobs.

Ok, then why it is so important for the inflation not to go astray too much from the initial course? It is because a substantial deviation would cost us some dear points of credibility would inhibit investors and creditors. Under the circumstances when inflation pushes us to the outskirts of CIS countries, any delay would be sanctioned harshly by the international community.

Having said that, we should not forget that monetary authorities stated in spring that under a pessimist scenario, they would categorically shoot for the target even if it were on the expense of slowing down economic growth. They explained that partially sacrificing economic growth in 2004 would consolidate the growth on a long term, which is exactly what Moldova needs to bridge the gap. Unfortunately, the things are exactly opposite. We would over-perform on economic growth and under-perform on inflation.

Finally we have one last issue to discuss. NBM claims that inflation would go down at the end of 2004, however it predicts that inflation decline would halt temporarily early next year as a result of surging energy price and high oil price. Albeit we agree in principle with that position, still skyrocketed prices on food are likely to propel a general price hike.

Noteworthy, in September and October bread and meat manufacturers were hardly persuaded to adjourn or diminish the price hike. In order to be more persuasive, Government gave up on important sources of revenues, it temporarily reduced by half the customs tax on certain food products. Inevitably, the realities would prove that administrative measures have a limited impact.

After elections nothing would stop manufacturers to raise the prices. Inflationist outburst would last for as long as the money from electoral charity would last. And why is it that food counts more than energy when it comes to inflation? That is because in 2005 consumption basket at the Statistics Department, the energy price would have the reduced weight of 2003, whereas food would have the high weight it used to. According to this scheme, it is not the energy that fuels inflation, but rather meat, bread and diary.

The end of the year casts a glimpse many politicians refuse to see: monetary policy has reached its limits in administering economy. Furthermore, reduction of arrears is necessary for a healthy drop of inflation.